
Press Releases

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2 June 1998

Compensation Arrangements for CA Pacific Securities Clients

The Council of the Stock Exchange of Hong Kong (SEHK) today resolved that it would allow a sum of not more than \$150,000 per client towards the compensation of CA Pacific Securities clients, in accordance with the policies announced by the Government, the Securities and Futures Commission (SFC) and the SEHK in January 1998. The resolution requires the SFC's approval, as stipulated in the Securities Ordinance, before it can be proceeded with. (An illustration is at Annex 1)

Section 109 of the Securities Ordinance (SO) states that where a person has a cause of action against a stockbroker in relation to any money, securities or other property entrusted to or received by the stockbroker, in the course of that stockbroking business, that person shall be entitled to claim compensation from the Unified Exchange Compensation Fund in respect of any pecuniary loss suffered by him.

As announced in January, cash clients of CA Pacific Securities will generally be eligible, as will clients of CA Pacific Securities who had signed margin agreements with CA Pacific Finance and had not used the facility under the agreements. In determining whether margin clients had ever used margin facilities, the relevant period to be looked at would be from 1 June 1997 to 19 January 1998, the date of default of CA Pacific Securities, approximately seven months. Clients claiming that they had not used the margin facility have to substantiate their claims by their trading record and account statements.

The Government, the SFC and the SEHK agreed in January to relax the compensation rules and compensation limit in relation to the default of CA Pacific Securities as they had determined that if the usual \$8 million limit were observed, the compensation that each client might receive would likely be very limited. (The

press release made by the Government on 25 January is at Annex 2).

According to the books and records of CA Pacific Securities and CA Pacific Finance as provided by the Provisional Liquidators, the two companies had a total of over 11,000 clients (including inactive clients and clients with zero or negative balances) representing holdings of approximately \$1.4 billion of securities valued as at 19 January 1998.

Upon closing of the three-month period for submission of claims, 5,212 claims were received by the SEHK. The amount claimed for the value of the securities has been adjusted using the closing price of shares as at 19 January 1998. Together with cash claims, the total amount claimed was approximately \$2.4 billion. As can be seen, there is a large discrepancy between the amounts claimed and the amounts shown in the companies' records.

The SEHK has also received 43 late submission of claims as of 9 June 1998. The SEHK's Compensation Committee on a case-by-case basis will determine admission of these late claims.

The payment level of \$150,000 will, assuming all potentially eligible clients are entertained, represent 81% of claimants being fully paid on the basis of company records (or \$325 million in total payment), or 70% on the basis of claims submitted and adjusted by the share closing price of 19 January 1998 (or \$412 million in total payment).

Upon completion of the initial injection of \$150 million each from the SEHK and the SFC, the Compensation Fund will stand at about \$800 million before the payment of the claims. Further injection into the Compensation Fund has been dealt with in the January announcement (Annex 2).

Under Section 113 of the SO, the SEHK has now begun to process the claims. Each case will be determined in accordance with the evidence provided by the claimant and the records of the companies. It is provided by law that the onus of proof of a claim lies upon the claimant.

The SEHK is proceeding with the processing of claims as quickly as possible, so as to enable the first batch of payments by the Compensation Fund by the autumn of 1998. Claims from cash clients will be processed first.

Upon payment, a client's right to claim under the liquidation process will be

subrogated, but only to the extent of the payment, to the SFC as the statutory trustee for the Compensation Fund. Those clients who are not fully compensated through this compensation process are entitled to claim in the liquidation process for any loss over and above what is paid to him by the Compensation Fund. (An illustration is in Point 3 in Annex 1).

As the existing compensation scheme is based upon a ceiling of \$8 million per broker failure and an extension of the ceiling allowed only in individual cases, the scheme as intended to be applied to CA Pacific Securities clients would have to be implemented through a number of minor legislative amendments. These legislative amendments are being drafted by the Government and it is expected they shall be introduced into the Legislative Council in July 1998.

Furthermore, liquidators once appointed by the Court intend in the near future to apply to the Court for directions to determine the respective rights of creditors and whether or not certain claimants are entitled to have their shares to be returned in specie. If shares are ultimately found to be returnable, arrangements will be made for claimants to repay the Compensation Fund and receive their shares back. (See Point 4 in Annex 1).

Claimants whose claims are not allowed or partially allowed may commence proceedings in court to establish their claims against the Compensation Fund. Subject to the merits and financial eligibility test mandated by the Legal Aid Ordinance for individual applicants, such proceedings would generally be eligible for legal aid.

For further information, please contact Henry Law of the SEHK (2840 3862), and Chan Chi Keung (2842 7624) or Bill Weeks (2840 9289) of the SFC.

Annex 1

Examples of Compensation Fund Payments

1. Each claimant whose claim is allowed by the Stock Exchange may initially receive the value of the allowed

claim up to \$150,000. Remember that the allowed amounts are calculated based on share values at 19 January 1998.

<u>Allowed Claim</u>	<u>Initial Compensation Payment</u>
\$10,000	\$10,000
\$50,000	\$50,000
\$150,000	\$150,000
\$200,000	\$150,000
\$1,000,000	\$150,000
\$10,000,000	\$150,000

2. Each claimant is also entitled to receive a pro rata share of the original \$8,000,000 limit under the Securities Ordinance. In other words, no claimant will receive less than what he or she would have received under the original provisions of the Securities Ordinance. However, any such amounts cannot be calculated until all claims have been determined and any appeals have been resolved.

<u>Allowed Claim</u>	<u>Initial Compensation Payment</u>	<u>Pro Rata Share of \$8,000,000*</u>	<u>Additional Compensation Payment</u>
\$10,000,000	\$150,000	\$200,000	\$50,000

* This amount is for illustration only. The actual pro rata figures will not be available for some time. The ratio is determined by dividing the \$8 million by the total amount of allowed claims, or in this example 0.02 based on hypothetical allowed claims of \$400 million.

3. Apart from the compensation payment, all clients of CA Pacific Securities and CA Pacific Finance are eligible to claim in the liquidation proceeding and to receive a distribution as creditors. The SFC as trustee for the Compensation Fund is subrogated by law to the claimants?

rights in the liquidation, but only to the extent of the compensation payment made to each claimant. The example below shows how the process works assuming a 50% distribution in the liquidation (for illustration purposes only). A claimant will not receive less overall by virtue of receiving compensation payments.

<u>Allowed Claim</u>	<u>Assumed Insolvency Distribution (A)</u>	<u>Compensation Payment (B)</u>	<u>Insolvency Distribution Paid to Claimant (A-B)</u>
\$10,000	\$5,000	\$10,000	NA
\$50,000	\$25,000	\$50,000	NA
\$150,000	\$75,000	\$150,000	NA
\$200,000	\$100,000	\$150,000	NA
\$1,000,000	\$500,000	\$150,000	\$350,000
\$10,000,000	\$5,000,000	\$150,000	\$4,850,000

4. There may be cases where a claimant is entitled to a return of securities in the liquidation, and who has already been paid from the Compensation Fund. The principle to apply will be that no claimant will be worse off for having claimed from the Compensation Fund. If the securities have a value greater than the Compensation Fund payment, the claimant may repay the Compensation Fund and receive the return of securities in the liquidation.

<u>Allowed Claim</u>	<u>Compensation Payment</u>	<u>Insolvency Distribution Available</u>
\$75,000 (representing 2,000 shares in ABC valued at 19 Jan. 1998)	\$75,000	2,000 shares in ABC (assume value has risen to \$100,000)

Claimant may receive return of securities upon repayment of \$75,000 to Compensation Fund.

Press Release by the Hong Kong Special Administrative Region Government

on 25 January 1998

Compensation Fund Rules and Upper Limit Relaxed

In the light of the C A Pacific Securities liquidation incident, the Government has agreed to relax the current compensation rules and the upper limit of compensation of the Compensation Fund. Meanwhile, a special task force will be established under the Securities and Futures Commission (SFC) and the Hong Kong Stock Exchange (SEHK) to receive claims.

This was announced today by the Secretary for Financial Services, Mr Rafael Hui, the SFC Chairman, Mr Anthony Neoh, and the SEHK Chairman, Mr H C Lee.

As there might be cases where clients of C A Pacific had been led to open margin account without their consent or under misrepresentation, the authorities considered that a more flexible approach should be adopted in assessing their claims against the Compensation Fund. The principle was that so far as their trading record and account statements had not indicated the use of the margin facility, they would be regarded as cash clients and would be entitled to claim compensation under the Compensation Fund.

Under the current compensation rules, the maximum compensation payable to claimants against any single registered broker was \$8 million. If this rule was to be observed, even if a flexible approach was adopted in assessing claims as outlined above, the compensation that each claimant may receive from the Compensation Fund would likely be very limited.

In view of this, the Government agreed that the upper limit of compensation should be set on a per claimant basis. In other words, each qualified claimant may receive a certain sum of money as compensation and would not be subject to the \$8 million limit. In this case, the compensation that each claimant may receive under the proposed arrangement would be more than what would otherwise be available if the \$8 million ceiling per broker was maintained.

The Fund was established by the Government in 1985 with a view to providing

protection for securities investors. The Fund at present has \$480 million.

Mr Hui said: "In order to put investors' hearts at ease, we will increase the Compensation Fund as well as making flexible arrangements. The SEHK and the SFC will each inject \$150 million into the Fund immediately and if necessary, another \$150 million will be injected by each party."

"The Government has also undertaken to apply to the Finance Committee of the Provisional Legislative Council for a loan to top up the Fund when it falls below the prudential level."

Mr Neoh said : "The SFC and SEHK will work closely with the provisional liquidator to verify and assess the claims received. The ceiling of compensation will be determined on completion of the actuarial assessment. However, the amount will certainly be higher than what would otherwise be available if the \$8 million ceiling per broker is maintained."

Mr Lee said: "The SFC and SEHK has set up a special task force to assist C A Pacific Securities clients to register their claims and to apply for claims to the Compensation Fund under existing securities regulations."

"The task force will liaise with the provisional liquidator to obtain a list of the clients and will contact the clients to assist them in filling out the applications for claims. The SEHK will also publish advertisements to notify clients to submit compensation claims."

"A telephone hotline to answer enquiries from C A Pacific Securities clients has been set up by the SEHK. The telephone number is 2840 3729."

The SFC will closely monitor the financial position of the broker-related margin finance companies and step up its supervision on margin trading activities. Where necessary, appropriate measures will be taken to protect the interests of investors.

Meanwhile, the Government will introduce legislation to bring the margin financing activities under regulation as soon as possible in order to further strengthen the integrity of the securities market and enhance investor protection.

25 January 1998

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